BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

In the Matter of the Application of SOUTHERN CALIFORNIA WATER COMPANY (U 133-W), for an order authorizing it to increase rates for water service by $19,826,100 or 29.72% in the year 2003; by $6,327,800 or 7.31% in the year 2004; and by $6,326,200 or 6.81% in the year 2005 in its Region III Service Area and to increase rates for the General Office allocation in all of its Customer Service areas in this Application Including: Arden-Cordova, Bay Point, Clearlake, Los Osos, Ojai, Santa Maria, Simi Valley and Metropolitan.	)	A. 02-11-007

CITY OF FOLSOM'S ADDITIONAL COMMENTS ON THE PROPOSED DRAFT DECISION OF PRESIDENT PEEVEY AND COMMISSIONER KENNEDY

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Dated: April 14, 2004

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

FEDERAL CASES

STATE CASES

FEDERAL STATUTES AND CONSTITUTION

STATE STATUTES AND CONSTITUTION

PUBLIC UTILITIES COMMISSION DECISIONS

Pursuant to Rule 77 of the Commission's Rules of Practice and Procedure and the April 2, 2004 Assigned Commissioner's Ruling Addressing the City of Folsom's Petition for Modification of Decision 04-03-039, the City of Folsom ("Folsom" or "the City") hereby submits its additional comments on the Proposed Draft Decision of President Peevey and Commissioner Kennedy ("Proposed Decision").

The City's Petition for Modification focuses on one issue – the Commission's treatment of the City of Folsom's water rights, acquired from Southern California Water Company ("SCWC") in 1994. D.04-03-039 states that, due to SCWC's failure to seek the Commission's prior approval for the transfer,[1] the City's prospective property rights are unclear, and it orders the parties to brief "the rights of Folsom" to that water under a number of different scenarios, and specifically contemplates that SCWC may "regain the use of the water rights it attempted to lease to Folsom." D.04-03-039, mimeo at p.53. D.04-03-039 therefore expressly contemplates the voidance of the City's water rights, even though it impliedly found that the City was an innocent party in the transaction – a good faith purchaser for value.[2] The Proposed Decision removes this cloud – and expressly states that the "Commission does not have the power under § 851 to declare Folsom's title to the water rights void" and that "§ 851 protects the City's acquired interest in the water both with respect to the past and to the future notwithstanding the voiding of the lease as to SCWC."

The Commission should adopt the Proposed Decision because D.04-03-039's treatment of the City's property rights is legally incorrect – Section 851 establishes a "conclusive presumption" in favor of bona fide purchasers for value – as to such parties, their property rights are inviolate and may not be voided because a utility failed to seek the Commission's prior approval to make such a transfer. Cal. Pub. Util. ("P.U.") Code Section 851. The City respectfully submits that Section 851 is absolutely clear on this point. To the extent any such ambiguity exists, it must be resolved by reference to Section 3 of the 1951 Amendments – which contains an express declaration of legislative intent that shows beyond any doubt that a good faith purchaser for value retains its property rights despite the lack of prior Commission approval for the transfer. The Commission has remedies for encouraging the compliance of utilities with

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[1] The City takes no position with respect to the merits of this particular issue, and has petitioned the Commission solely to clarify the City's continuing right to the property it acquired in 1994 from the utility.

[2] The Commission's decision has immediate and significant adverse consequences for the City and its communities – which are explained in the City's Petition for Modification and the Supporting Declaration of Steven P. Rudolph ("Rudolph Decl."), filed with the Commission on March 26, 2004.

Section 851, and controls the allocation of the consideration received by the utility. The Commission may not, however, void a transfer to a good faith purchaser for value.

Accordingly, the Proposed Decision should be adopted to cure the defect in D.04-03-039. The City submits herein for the Commission's consideration a complete analysis of Section 851, including an analysis of the relevant CPUC precedent and case law, the legislative history, analogous common law and statutory protections for innocent purchasers, as well as an analysis of some constitutional questions raised by the Commission's decision. The City also takes this opportunity to address the March 30, 2004 Comments of the Office of Ratepayer Advocates on the Draft Decision of President Peevey and Commissioner Kennedy ("ORA Comments"), and to explain why the ORA has misinterpreted the law.

I. Section 851 Unambiguously Protects Property Interests Acquired by Good Faith Purchasers for Value from Being Invalidated on the Ground that the Utility Failed to Seek the Commission's Approval

In inquiring into the proper construction of Section 851, the Commission applies the usual rules of statutory interpretation as articulated by the California Supreme Court. *See* D.97-11-020, 1997 Cal. PUC LEXIS 1033, at *7. The "fundamental rule" of interpretation is to "ascertain the intent of the Legislature." *Klajic v. Castaic Lake Water Agency*, 90 Cal. App. 4th 987, 997 (2001). First, the Commission must "look to the words of the statute and try to give effect to the usual, ordinary import of the language . . . ." *Id.* Only if the language is ambiguous may the legislative history be considered. *Pac. Gas & Elec. Co. v. Dep't of Water Res.*, 112 Cal. App. 4th 477, 495 (2003).

A. The Plain Language of Section 851, Including an Express Declaration of Legislative Intent Which Accompanies It, Conclusively Establishes the Rights of Good Faith Purchasers for Value in their Acquired Property

"When statutory language is . . . clear and unambiguous there is no need for construction, and courts should not indulge it." *Cal. Ins. Guarantee Ass'n v. Liemsakul*, 193 Cal. App. 3d 433, 439 (1987) (quotation omitted). Under the first paragraph of Section 851, a utility that disposes of "necessary or useful" property must seek the Commission's approval. P.U. Code Section 851. If it does not, the transaction is void. The second paragraph contains an "***exception to the harsh***

results" of Section 851, *Ponderosa Cmty. Serv. Dist.*, D.99-11-020, 1999 Cal. PUC LEXIS 858, at *11 (emphasis added), and that exception provides that "as to any purchaser, lessee or encumbrancer dealing with the property in good faith for value," the disposition "shall be conclusively presumed" to be of property which is not necessary or useful. *Id.* (quoting Section 851).

A presumption is "an assumption of fact which the law requires to be drawn from another fact . . . ." Cal. Evid. Code § 600(a). If the presumption is conclusive, as here, then "where the first fact is shown to exist, the second fact's existence is wholly immaterial for the purpose of the proponent's case . . . ." *People v. Dillon*, 34 Cal. 3d 441, 474 (1983) (quotation omitted). A presumption is a "highly artificial concept," *People v. Johnson*, 38 Cal. App. 3d 1, 8 (1974) (quotation omitted), and is "established to implement some public policy" such as ***"the policy in favor of . . . the stability of titles to property*** . . . ." Cal. Evid. Code § 605 (emphasis added). Where the "first fact" is established, then evidence may not be admitted to controvert the "second fact," – the presumed fact "is made definitely conclusive – incapable of being overcome by proof of the most positive character." *Heiner v. Donnan*, 285 U.S. 312, 324 (1932).

Applying these principles of law to the present case, here, the "first fact" is the City's status as a good faith purchaser for value. Once that is established, the "second fact" – that the property was not necessary or useful – is conclusively presumed to exist by legislative fiat, and it "may not be controverted by contrary evidence." *Plaza Hollister Ltd. P'ship v. County of San Benito*, 72 Cal. App. 4th 1, 27 (1999). Hence, the legislature has mandated that a property interest acquired by a good faith purchaser for value may not be voided by the Commission, notwithstanding a failure on the part of a utility to seek the Commission's approval. [3]

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[3] In the Commission's April 1, 2004 meeting, Commissioner Brown stated his position that "the conclusive presumption . . . is only triggered when it is established that the particular asset that is sold or leased is neither necessary or useful." (Transcript of Commission Meeting, April 1, 2004.) With every respect due to the Commissioner, this analysis puts the cart before the horse. The conclusive presumption presumes the fact to exist by legislative fiat – and evidence to the contrary is irrelevant, no matter how strong. *Dillon*, 34 Cal. 3d at 474; *Griffiths v. Superior Court*, 96 Cal. App. 4th 757, 777 (2002) ("Once foundational facts upon which such a presumption is based are established, the assumed fact may not be contradicted by contrary evidence.").

Here, the "foundational fact" is the City's status as an innocent purchaser for value. The Commission has already recognized that the City is indeed an innocent purchaser, and no party to these proceedings contends otherwise, nor could they. It therefore follows as a matter of law that the "presumed fact" – that the property in question was not necessary or useful – is established. In the Supreme Court's words, "the issue . . . is wholly immaterial for the purpose of the proponent's case . . . ." *Dillon*, 34 Cal. 3d at 475 (quoting Wigmore).

Moreover, such an interpretation would render the good faith purchaser provisions of Section 851 meaningless. If, as Commissioner Brown suggests, the good faith purchaser provision is only triggered on a finding of the Commission that the property was not necessary or useful, then there would be no need to afford protections

The City respectfully submits that the statutory scheme is clear. However, if the Commission entertains doubts as to the proper application of this scheme, "any possible ambiguity in the statute must be resolved by reference to Section 3 of the 1951 amendment to section 851, which contains an express statement of legislative intent . . . ." *Kreske v. Eyman*, 269 Cal. App. 2d 840, 844 (1969). Section 3 provides:

> It is hereby declared that the amendments to the Public Utilities Act made by this act are intended as a clarification of the meaning thereof rather than a substantive change therein and the provisions thereof should be construed for all purposes as though they had heretofore read as set forth in this act. Any sale, lease, encumbrance or other disposition heretofore made by any public utility of its property to a purchaser, lessee or encumbrancer dealing with such property in good faith for value shall be conclusively presumed to have been of property which is not useful or necessary in the performance of such public utility's duty to the public and ***such past transactions are hereby confirmed, validated and declared legally effective as having been made and effected in conformity with the provisions of subsection (a) of Section 51 of the Public Utilities Act and Section 851 of the Public Utilities Code.***

Stats. 1951, ch. 402, § 3 (emphases added); (Declaration of Derek F. Foran ("Foran Decl."), submitted herewith, ¶ 3, Ex. A.)

Kreske involved an action to quiet title in an easement. The plaintiff in the case had derived his title from a seller who in turn had taken by a conveyance from a public utility, which had made the conveyance without having obtained the Commission's approval. 269 Cal. App. 2d at 841. The seller was a shareholder and incorporater of the public utility, and the court therefore concluded he was not a buyer in good faith. *Id.* The plaintiff in the quiet title action argued that he should be protected by the conclusive presumption in Section 851 because he himself, unlike the seller, was a good faith purchaser for value. *Id.* at 843. The Court held that while "it may be arguable" that the statute was "sufficiently broadly worded to encompass such a subsequent purchaser," the plaintiffs construction could not prevail, because "***any possible***

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to innocent purchasers, since the Commission's prior approval would not have been necessary, and the Commission would have no power to void the transaction. Commissioner Brown's proffered interpretation therefore violates "[a] cardinal rule of statutory construction" which requires that "all words of a statute" be given effect. *Livermore Valley Joint Unified Sch. Dist. of Alameda County & Contra Costa County v. Feinberg*, 37 Cal. App. 3d 920, 922 (1974); *see also* D.97-02-014, 1997 Cal. PUC LEXIS 76, at *52 ("A construction making some words surplusage is to be avoided.").

ambiguity in the statute must be resolved by reference to section 3 of the 1951 amendment to section 851, which contains an express statement of legislative intent" and provides that the conclusive presumption applies "***only to a sale 'by any public utility of its property . . . to any purchaser . . . dealing with such property in good faith for value . . . .***'" *Id.* at 844 (quoting Section 851) (emphases added).

The legislature's intent, clearly – was to protect "purchasers . . . dealing with such property in good faith for value" whose transactions are "***hereby confirmed, validated and declared legally effective***" in conformity with Section 851. Stats. 1951, ch. 402, § 3 (emphasis added). The second paragraph of Section 851 functions as an exception to the first paragraph of Section 851 – by legislative fiat the first paragraph is subordinate to the second – not the other way around. This legislative pronouncement demonstrates that a good faith purchaser for value retains acquired property rights – and should resolve any concerns regarding the proper operation of the statutory scheme. *See Kreske*, 269 Cal. App. 2d at 843 ("any ***possible ambiguity*** in the statute ***must be resolved*** by reference to section 3") (emphases added).

Rules of statutory interpretation require that the Commission's inquiry end here. *See* D.04-04-020, mimeo at p.4 ("If the language is unambiguous, then the language controls and the inquiry is over."); 1997 Cal. PUC LEXIS 76, at *51 ("We have stated time and again that [one] must presume that the legislation says in statute what it means and means in statute what it says there.") (quotation omitted) (modification in original). Because the Commission is statutorily precluded from voiding a transaction as to a good faith purchaser for value, it should adopt the Proposed Decision to remedy the defect in D.04-03-039.

B. CPUC Precedent, California Case Law and Analogous Protections for Good Faith Purchasers for Value all Support the Plain Language Construction of Section 851

While further analysis is unnecessary in light of the language of Section 851 and the express declaration of legislative intent which accompanies it, the Commission's precedent, analogous statutory protections for good faith purchasers, and California case law also supports the conclusion that the second paragraph of Section 851 protects the City's property interest from being voided pursuant to the first paragraph.

The Commission has heretofore been consistent in its approach to Section 851 – good faith purchasers for value are protected and their property interests may not be voided for want of the Commission's approval. In *Ponderosa Community Services District*, the Commission held that the good faith purchaser rule functioned as an "***exception to the harsh results of § 851***" and as such, "a good faith purchaser for value ***may obtain the property notwithstanding the lack of Commission authorization***." D.99-11-020, 1999 Cal. PUC LEXIS 858, at *5, *11 (emphasis added). And in *County of Inyo v. LADWP*, the Commission applied the conclusive presumption in favor of a good faith purchaser for value notwithstanding the sale of necessary or useful property without the Commission's prior approval:

> [N]o party has contended before this Commission that the defendant was not a good faith purchaser for value. The complainant alludes to no direct evidence it could present to show the defendant was not a good faith purchaser for value. . . . While the passage of time and ensuing reliance does not absolve all alleged regulatory transgressions, given the passage of time, years of reliance by Owens Valley inhabitants and the defendant, and the lack of any offered evidence to the contrary, we find that the defendant was a good faith purchaser for value. ***Accordingly, the purchase . . . by the defendant is validated and legally effective pursuant to Section 851.***

D.89576, 1978 Cal. PUC LEXIS 1374, *32-33 (emphasis added); *see also Francis Land & Water Co.*, D.96-09-086, 1996 Cal. PUC LEXIS 959, at *31 (noting that good faith purchasers excepted from provisions of first paragraph of Section 851); *Cf.* D.01-08-069, 2001 Cal. PUC LEXIS 519, at *33 (granting a Section 851 application because, inter alia, "denial of the Application would not really punish PG&E, but rather would most directly harm [the purchaser], and secondarily harm the residents of California who may benefit from the operation of the [purchaser's] plant."); D.02-01-055, 2002 Cal. PUC LEXIS 3, at *8 (granting an exemption under P.U. Code § 853 because "the customers who purchased the assets from PG&E did so in good faith and for value. It would be unfair to force these customers or their successors in interest to now relinquish the assets. . . . Due to the passage of time, it is probably not possible, as a practical matter, to unwind the sales.").

The *Pacific Gas & Electric* case contains the most complete articulation of the Commission's thinking with respect to the good faith purchaser provisions of Section 851. The Commission explained as follows:

> [T]he presumption is "as to any purchaser, lessee or encumbrancer dealing with such property in good faith for value." This language echoes the definition of a bona fide purchaser for real property (see *Scheas v. Robertson* (1951) 38 Cal. 2d 119, 128 ("a 'bona fide purchaser is one who takes in good faith and for value . . .'")), and this emphasis makes it clear that this provision is ***intended to protect innocent purchasers from having their transactions invalidated solely on the ground that the utility's action in transferring the property was beyond its authority.*** (Cf., Civil Code § 1214 (establishing the validity of the first-recorded conveyance of real property).).

D.92-07-007, 1992 Cal. PUC LEXIS 599, at *14-15 (emphasis added).

As the Commission recognized in *Pacific Gas & Electric*, pursuant to principles of real property law a bona fide purchaser for value "takes the property free of . . . unknown rights." *Hochstein v. Romero*, 219 Cal. App. 3d 447, 451 (1990). Bona fide purchasers were so protected under the common law at the time the precursor to Section 851 was enacted in 1911, and the rule is that "statutes should not be interpreted to alter the common law, and should be construed to avoid conflict with common law rules." *Cal. Ass'n of Health Facilities v. Dep't of Health Serv.*, 16 Cal. 4th 284, 297 (1997) (quotation omitted).

Conclusive presumptions in favor of innocent purchasers are not unusual – the California statutes contain many examples of conclusive presumptions in favor of good faith purchasers for value. For example, there is a conclusive presumption in favor of bona fide purchasers for value of partnership assets that persons listed in a recorded statement of partnership are partners. *See* Cal. Corp. Code § 16303. The effect of the conclusive presumption is "to make binding upon a partnership obligations which are incurred in the partnership's name by persons listed in a recorded partnership statement," notwithstanding a purported lack of authority to make the transfer. *FDIC v. Superior Court*, 54 Cal. App. 4th 337, 346 (1997). There is also a conclusive presumption in favor of a bona fide purchaser for value who takes a real property interest at a nonjudicial foreclosure sale if the trustee's deed recites that the conduct of the foreclosure sale was proper. *See* Cal. Civil Code § 2924. The conclusive presumption "precludes an attack [on the validity of the sale], ***even though there may have been a failure to comply with some required procedure*** . . . ." *Moeller v. Lien*, 25 Cal. App. 4th 822, 831 (1994) (emphasis added). These presumptions in favor of innocent purchasers for value are designed to "give certainty, finality and security" to such conveyances notwithstanding some procedural irregularity in the

sale. *Sipe v. Correa*, 38 Cal. 2d 131, 135 (1951). So too with respect to the conclusive presumption in Section 851. *See Pac. Gas & Elec. Co.*, D.92-07-007, 1992 Cal. PUC LEXIS 599, at *14-15; *County of Inyo*, D.89576, 1978 Cal. PUC LEXIS 1374, at *32-33.[4]

Finally, the case law also supports the conclusion that the transfer to the City cannot be voided. As was previously mentioned, in *Kreske*, the Court held that "any possible ambiguity in the statute must be resolved by reference to section 3 of the 1951 amendment," which contains an "express statement of legislative intent" and provides that transactions with good faith purchasers for value are "validated and declared legally effective as having been made and effected in conformity with the provisions of subsection (a) of Section 51 of the Public Utilities Act and Section 851 of the Public Utilities Code." 269 Cal. App. 2d at 843 (quoting Stats.1951, ch. 402, § 3). In *County of Los Angeles v. Southern California Edison* the court noted that "[p]roperty sold to a purchaser dealing with such property in good faith for value is conclusively presumed to be property that is not necessary or useful." 112 Cal. App. 4th 1108, 1120 (2003) (quoting Section 851). And in *Camp Meeker v. Public Utilities Commission* the Supreme Court held that the Commission's functions "do not include determining . . . interests in or title to property, those being questions for the courts." 51 Cal. 3d 845, 861 (1990). The Supreme Court held that the Commission only had the power "to construe . . . the existing rights of a regulated utility," such right being necessary "to ensure that a purchaser . . . would not be entitled to assert

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[4] For these very reasons, the statute of limitations for invalidating the 1994 agreement has long since expired. In *Marin Healthcare Dist. v. Sutter Health*, 103 Cal. App. 4th 861 (2002), for example, a public entity sought to void a 12-year-old lease pursuant to Government Code sections 1090 and 1092, which declare void any contract entered into by a public employee who has a financial interest in the transaction. In that case, the public-entity lessor and non-profit lessee had the same CEO and legal counsel when the deal was struck in 1985. *Id.* at 867. But despite these blatant violations of the Government Code, the *Marin* court refused to hear the case and rebuked the public entity's attempt to unwind 12 years of a contractual relationship. Further, the court pointed out the obvious and devastating effects of allowing such stale claims to find purchase in the courts:

> Defendants' uninterrupted operation of the hospital facility for nearly half of its 30-year lease before suit was brought certainly gave rise to a legitimate expectation that the 1985 contracts would not be challenged and that defendants could rely on those contracts in making investment decisions. Such expectations are precisely what the Legislature chose to protect when it expressly subjected the state to the same limitation periods that bind private parties' contract, tort, and statutory claims.

Id. at 888; *see also* Cal. Civ. Proc. Code § 345 (applying statutes of limitations to actions brought by, or for the benefit of, the state or county). If the ORA had brought this Section 851 challenge to court, the *Marin* case would undoubtedly bar the action. The Commission's ability to reach into the past cannot exceed the restrictions laid down by the California Legislature and the courts of this state.

the conclusive presumption of the second paragraph of section 851 . . . ." *Id.* at 862 (emphasis added).

In short, CPUC precedent, analogous common law and statutory protections for good faith purchasers, and California case law all support the conclusion that the Commission may not void a property interest acquired by an innocent purchaser for value.

C. The Limited Legislative History Supports the Plain Language Construction

"Where, as here, legislative intent is expressed in unambiguous terms," the Commission "must treat the statutory language as conclusive." *Jarrow Formulas, Inc. v. LaMarche*, 31 Cal. 4th 728, 736 (2003) (quotation omitted). Nevertheless, the City submits that the legislative history buttresses the plain language construction of Section 851.

The language of present P.U. Code Section 851 is derived from former section 51(a) of the Public Utilities Act of 1915, which in turn was a reenactment of the 1911 Railroad Commission Act. The text of uncodified section 51(a) as introduced in 1911 was substantially the same as the language of present Section 851, and provided that "any sale of [a utility's] property by such utility shall be conclusively presumed to have been of property which is not useful or necessary in the performance of its duties to the public, as to any purchaser of such property in good faith for value." Commentary on individual sections of the bill is not directly given in the types of material surviving to document the consideration of uncodified section 51(a), however.

Former section 51(a) was amended and codified in 1951 following legislative passage of Assembly Bill 389. The amendments made it clear that the "protection given . . . to good faith purchasers for value of property of a public utility extends likewise to any lessee or encumbrancer dealing with such property in good faith." (Foran Decl., ¶ 4, Ex. B.) Prior to the 1951 Amendments, lessees and encumbrancers were not expressly included in the good faith purchaser provisions. The amendment was "in reality a re-statement of the law in conformance with the general practice under the section which has had the concurrence of the Public Utilities Commission." (Foran Decl. ¶ 5, Ex. C.) While, again, there is a paucity of commentary with respect to individual sections, there are three points to note about the 1951 codification.

First, and by far the most important, the legislature saw fit to include an express declaration of its intent with respect to the proper application of the good faith purchaser exception – past transactions of good faith purchasers for value were "***confirmed, validated and declared legally effective as having been made and effected in conformity with the provisions of subsection (a) of Section 51 of the Public Utilities Act and Section 851 of the Public Utilities Code.***" Stats. 1951, ch. 402, § 3 (emphasis added). This express declaration of legislative intent makes speculation as to Section 851's meaning absolutely unnecessary.

Second, the legislation was introduced by the California Land Title Association in order to clarify the present law concerning good faith purchasers for value. The Title Association took the position that a clarification was necessary to ensure that good faith encumbrances were covered by the good faith purchaser provision. (Foran Decl., ¶ 4, Ex. B.) The mere fact that the Land Title Association sponsored the legislation is itself significant.[5] The Association also sponsored a "conclusive presumption" in favor of good faith purchasers for value of property at nonjudicial foreclosure sales, the purpose of which was "***to promote certainty in favor of the validity of the . . . sale.***" *Homestead Sav. v. Darmiento*, 230 Cal. App. 3d 424, 433-34 (1991) (emphasis added).

Third, the Public Utilities Commission was asked to comment on the new legislation, and it saw "no objection to the enactment of Assembly Bill No. 389." (Foran Decl. ¶ 6, Ex. D.) A draft of the legislation was submitted to the Commission's Chief Counsel, Chief Judge Everett C. McKeage, and to the Commission itself, which were "of opinion that the measure merely clarifies existing law" and carried out what was "logically assume[d] to be the original intent of the Legislature when the last sentence of Subsection (a) of Section 51 of the Act was enacted." (Foran Decl. ¶ 4, Ex. B.) And of course, since 1911 the last sentence of Subsection (a) had shielded good faith purchasers for value from having their transactions voided solely because a utility had failed to secure the Commission's approval for the transaction. The "original intent" of the legislature was expressly stated in Section 3 of the 1951 Amendments, and clearly protects the property interests of good faith purchasers for value from being invalidated.

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[5] *E.g., Teter v. Newport Beach*, 30 Cal. 4th 446, 455 (2003) (noting position taken by sponsor California State Sheriffs' Association); *Wash. Mut. Bank, F.A. v. Superior Court*, 95 Cal. App. 4th 606, 625 (2002) (noting position of legislative sponsor California Association of Realtors).

In short, what little legislative history there is on Section 851 and former Section 51(a) supports the conclusion that good faith purchasers for value are protected from having their property interests voided due to a utility's failure to seek the Commission's approval.

D. The Commission Should Construe Section 851 to Avoid Constitutional Infirmities

Finally, established rules of statutory construction require the Commission to "construe statutes to avoid constitutional infirmities." *Myers v. Philip Morris Cos.*, 28 Cal. 4th 828, 846 (2002) (quotation and internal modification omitted). If, after reviewing the plain language of the statute, the express declaration of legislative intent, CPUC precedent, analogous common law and statutory protections for good faith purchasers, California case law, and legislative history the Commission still questions the proper construction of Section 851, it is its "plain duty to adopt that construction which will save the statute from constitutional infirmity." *United States v. Congress of Indus. Org.*, 335 U.S. 106, 121 (1948). Here, D.04-03-039 as currently written raises significant constitutional questions – yet another reason why the Commission should adopt the Proposed Decision.

The Commission's jurisdiction is expressly limited by its constitutional authorization to regulate public utilities. Cal. Const., art. X, § 5; *id.*, art. XII, § 3. In *Camp Meeker* – a Section 851 case – the Commission conceded to the Supreme Court that it lacked the authority to adjudicate third party interests in property:

> The commission expressly recognizes that its functions do not include determining the validity of . . . interests in or title to property, those being questions for the courts. It claims only the power to construe, for purposes of exercising its regulatory and ratemaking authority, the existing rights of a regulated utility.

51 Cal. 3d at 862 (emphasis added). The Commission has thus far been true to its word, and has foresworn any power to "determin[e] the validity of . . . interests in or title to property" of third parties. *Id.* In *Fisch v. Garrapata Water Company*, the Commission held, consistent with *Camp Meeker*, that it did "not have jurisdiction equivalent to that of a court, to adjudicate incidents of title." D.03-04-037, 2003 Cal. PUC LEXIS 249, at *4. The Commission made the same point in *Ponderosa Community Services District*, a Section 851 case, when it observed that its jurisdiction does not "extend to determining . . . interests in or title to property." 1999 Cal. PUC

LEXIS 858, at *6. In *Rooney v. Polak*, the Commission repeated that "[t]he tasks of determining complainants' interest in or title to the property are . . . not for this Commission." D.02-02-045, 2002 Cal. PUC LEXIS 172, at *8; *see also* D.02-08-076, 2002 Cal. PUC LEXIS 520, at *25 ("The court's statement [in *Camp Meeker*] that the Commission recognizes that it does not have jurisdiction to determine the validity of contracts refers to property rights and to adjudicating incidents of title, not determining contractual rights generally.").

Despite this constitutional check on the Commission's power, D.04-03-039 reserves for future consideration "the rights of Folsom" as to the water it acquired in 1994, and expressly poses the question whether SCWC may "regain the use of the water rights it attempted to lease to Folsom." D.04-03-039, mimeo at p.55. The City of Folsom is not a utility subject to the Commission's jurisdiction, and as such its property rights may not be adjudicated by the Commission. *Camp Meeker*, 51 Cal. 3d at 861. There is no legal basis for the Commission to void the property rights of a good faith purchaser for value. [6]

In addition, the California Constitution "requires that the water resources of the State be put to beneficial use to the fullest extent of which they are capable, and that the waste or unreasonable use or unreasonable method of use of water be prevented . . . ." Cal. Const., art. X, § 2 (emphasis added). This provision "encompasses the use of all of the water within the state" and is "applicable to the settlement of all water controversies." *Cent. & W. Basin Water Replenishment Dist. v. S. Cal. Water Company*, 109 Cal. App. 4th 891, 904-05 (2003) (quotation omitted). The existing homes and commercial developments in the East Area of the City of Folsom use all five thousand acre-feet per year of the water supply purchased in 1994. (Rudolph Decl. ¶ 19.) The rights, therefore, could not possibly be put to any more of a beneficial use than

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6 In fact, D.04-03-039 is nothing short of a taking in violation of both the United States and California constitutions. *See* U.S. Const. amend. V; Cal. Const. art. I, §19. It is clear that water rights may be the subject of a physical taking. *See Tulare Lake Basin Water Storage Dist. v. United States*, 49 Fed. Cl. 313, 318-20 (2001) (citing *International Paper Co. v. United States*, 282 U.S. 399 (1931) and *Dugan v. Rank*, 372 U.S. 609, 625 (1963)). The Commission's act of stripping property from the City — which the Commission has conceded is an "innocent" party to this action — and taking it elsewhere for public use clearly gives the City rights against the Commission for just compensation.

Furthermore, basic due process requires that the Commission provide to all parties notice and an opportunity to be heard before it takes any action affecting any interest in "life, liberty, or property." *City of West Covina v. Perkins*, 525 U.S. 234, 240-41 (1999). No such opportunity was afforded to the City prior to the issuance of D.04-03-039. Consequently, and in addition to the takings issue discussed *supra*, the Commission's decision has violated the City's constitutional right to due process. This lack of notice prejudiced the City's ability to raise legal and equitable defenses including, but not limited to, laches and estoppel.

they already are. Transferring these rights to SCWC on the theory that the rights are useful "in enhancing SCWC's ability to meet future water supply contingencies," D.04-03-039, mimeo at 47-48, does not outweigh the present beneficial and full use of the water by the City. In short, the Commission's duty to avoid a construction of Section 851 that raises significant constitutional concerns requires it to modify D.04-03-039. *Congress of Indus. Org.*, 335 U.S. at 121.

II. The ORA's Argument that the City's Property Interest is Voided and its Remedy Lies in an Action Against the Utility is Precluded by an Express Statement of Legislative Intent to the Contrary and Violates Fundamental Principles of Statutory Construction

The Office of Ratepayer Advocates ("ORA") maintains that "nothing in Section 851 exempts the lease from being void for SCWC's failure to first obtain the Commission's authorization to enter into the lease." (ORA Comments, at 2.) The ORA further maintains that the Draft Decision – shielding Folsom's property rights as a good faith purchaser from being voided – is "contrary to the plain language of the statute," (*id.*), and argues that the Commission has already rejected "this very same argument." (*Id.*) Finally, the ORA asserts that shielding innocent purchasers from having their transactions voided "would render the entire statute meaningless" and that the innocent purchaser provision gives "Folsom a cause of action against SCWC." (*Id.* at 4.) According to the ORA then, Folsom's remedy lies in an action against the utility – it has no further rights in its property.[7]

The ORA's position with respect to the City's remedy is precluded by Section 3 to the 1951 Amendments, which provides that transfers between a utility and an innocent transferee "shall be conclusively presumed to have been of property which is not useful or necessary" and any such transactions "***are hereby confirmed, validated and declared legally effective as having been made and effected in conformity with the provisions of subsection (a) of Section 51 of the Public Utilities Act and Section 851 of the Public Utilities Code.***" Stats. 1951, ch. 402, § 3 (emphasis added). It therefore could not possibly be the case – as the ORA has insisted before this Commission – that the lease is void notwithstanding the City's status as a good faith purchaser for value. Section 3 makes it absolutely clear that the statute protects the property

[7] The ORA has also taken the position that the City's remedy lies against the utility in a series of ex parte communications with the Commissioners and their staff.

interests of such parties from subsequent invalidation. Any "***possible ambiguity***" in the statute "***must be resolved by reference to section 3, which contains an express statement of legislative intent***" with respect to the function of the good faith purchaser provision. *Kreske*, 269 Cal. App. 2d at 844 (emphases added). The ORA's position is therefore legally incorrect.

The ORA further argues that in *Pacific Gas & Electric* the Commission rejected the assertion that the good faith purchaser provision protects such parties' transactions from being invalidated. (ORA Comments, at 3.) This assertion fundamentally misconstrues the import of the *Pacific Gas & Electric* decision. As the ORA pointed out, in *Pacific Gas & Electric* the Commission found as follows:

> PG&E's argues [sic] that its agreement with MCI is an arm's length transaction and the property involved must be "conclusively presumed" to be not useful or necessary to the utility business. This argument could, if accepted, be used to dispose of all the utility's assets with impunity. This result is, of course, nonsensical, and this interpretation of the statute completely contradicts § 851's primary determination that unauthorized dispositions of utility property are void.

1992 Cal. PUC LEXIS 599, at *14. The Commission went on to explain how the bona fide purchaser provisions were meant to work:

> It makes much more sense to read this provision of § 851 to emphasize that the presumption is "as to any purchaser, lessee or encumbrancer dealing with such property in good faith for value." This language echoes the definition of a bona fide purchaser of real property (see *Scheas v. Robertson* (1951) 38 Cal. 2d 119, 128 ("a 'bona fide purchaser is one who takes in good faith and for value . . .'")), and this emphasis makes it clear that this provision is intended to protect innocent purchasers from having their transactions invalidated solely on the ground that the utility's action in transferring the property was beyond its authority. (Cf., Civil Code § 1214 (establishing the validity of the first-recorded conveyance of real property).)

Id. at *14-15. The *Pacific Gas & Electric* proceeding was a Section 851 proceeding wherein PG&E asked the Commission "to approve its agreement with MCI . . . ." *Id.* at 1. Since the transaction had not yet been consummated, MCI was not an "innocent purchaser" and the good faith provisions of Section 851 did not apply. The Commission correctly pointed out that the good faith purchaser provision has no application in such a context. The Commission then goes

on to explain that the provision is "intended to protect ***innocent purchasers from having their transactions invalidated solely on the ground that the utility's action in transferring the property was beyond its authority***." *Id.* at *15 (emphasis added). The City is such a party. As the City has already explained, SCWC's legal counsel represented to the City at the time of transfer that it had received all of the necessary governmental approvals to implement the reallocation provided for under the agreement. (Rudolph Decl. ¶ 7, Ex. D.) Contrary to supporting the ORA's argument, *Pacific Gas & Electric* actually disproves it.

And of course, the ORA's argument that the CPUC has already "rejected" the City's position cannot be reconciled with CPUC decisions that validated transactions involving innocent purchasers despite a utility's failure to seek prior Commission approval. *See County of Inyo*, 1978 Cal. PUC LEXIS 1374, at *32-33 (declaring a transfer to an innocent purchaser "***validated and legally effective pursuant to Section 851***" notwithstanding the utility's failure to seek Commission approval) (emphasis added); *Ponderosa Cmty Serv. Dist.*, 1999 Cal. PUC LEXIS 858, at *5, *11 (holding that innocent purchaser provision is an "***exception to the harsh results of § 851***" and that "***a good faith purchaser for value may obtain the property notwithstanding the lack of Commission authorization***") (emphases added).

In spite of the plain language of Section 851, the express declaration of legislative intent contained in Section 3 to the 1951 Amendments, CPUC precedent, California case law, long-standing principles protecting bona fide purchasers, and the constitutional issues raised by D.04-03-039, the ORA nonetheless maintains that the good faith purchaser provisions merely provide the City with a "cause of action" against SCWC. The ORA offers not one single case – after 94 years in which this provision is on the books – in support of this construction. Moreover, since the California Code of Civil Procedure already provides the City with remedies for, inter alia, breach of contract and misrepresentation,[8] the ORA's interpretation would render the good faith provisions of Section 851 redundant, thereby violating what the Supreme Court has called "one of the most elementary principles of statutory construction." *Cal. Pac. Collections, Inc. v. Powers*, 70 Cal. 2d 135, 139 (1969); *see also* 1997 Cal. PUC LEXIS 76, at *54 ("Adopting the interpretation put forth by the utilities would render that language superfluous, a practice to be avoided in statutory construction.").

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[8] *See* Cal. Civil Proc. Code §§ 25-30, 307, 337.

In light of the express explanation provided by the legislature in 1951 as to the proper application of Section 851, the only explanation for the ORA's position is its concern that affording the City the protections to which it is entitled under the statute would undermine the Commission's power to regulate a utility's disposition of its property. This is simply not the case. All that the second paragraph of Section 851 says is that the Commission may not void a transfer to a good faith purchaser for value. Moreover, the City submits that considerations of the Commission's authority have no place in legitimate statutory interpretation, the purpose of which is to "ascertain the intent of the Legislature," *Klajic*, 90 Cal. App. 4th at 997, no more.

In short, the ORA's proffered interpretation of Section 851 cannot be reconciled with an express declaration of legislative intent to the contrary, which conclusively establishes that a property interest acquired by an innocent purchaser for value may not be voided by the Commission. It is, moreover, inconsistent with prior commission precedent, with California case law, with long-standing common law and statutory protections for innocent purchasers, and with fundamental rules of statutory construction.

III. A Hearing on the City's Status Is Unnecessary in Light of Its Unquestioned Status as an Innocent Purchaser for Value and Would Only Prolong an Already Impossible Situation for the City

Finally, the April 2, 2004 Assigned Commissioner's Ruling suggests that if a responding party feels that evidentiary hearings are necessary, it should so state in its comments, along with a specific description of what specific disputed material facts are in question. The City submits that any such evidentiary hearing is unnecessary, and would only serve to further delay according the City that to which it is entitled – a modification of D.04-03-039 to relieve the City of the cloud that has been cast on its rights – to the further detriment of the City and its citizens. Consistent with Section 851, the only "material fact" at issue is the City's status as a good faith purchaser for value. Once that is established, then by legislative fiat it is conclusively presumed that the property was "not necessary or useful," and the Commission may not void the City's rights. P.U. Code Section 851.

On March 26, 2004, the City offered the Commission evidence that (1) SCWC's legal counsel advised the City that "no governmental permits or approvals [were] required to implement the reallocation," and (2) it has paid SCWC almost $7 million dollars over the past

decade for the rights it acquired. (Rudolph Decl. ¶¶ 7, 9.) These facts establish that the City has acted in good faith and for value. In *County of Inyo*, the Commission found that a party was a "good faith purchaser for value" based on a ***lack*** of evidence to the contrary. 1978 Cal. PUC LEXIS 1374, at *32-33 (noting that "no party . . . contended . . . that the defendant was ***not*** a good faith purchaser for value" and that there was "no direct evidence . . . to show the defendant was ***not*** a good faith purchaser") (emphases added). So too here – no party has so much as suggested that the City is not an innocent party, nor could it. Therefore, an "evidentiary hearing" would be a waste of time and money for all concerned, and would serve to further delay and exasperate an already impossible situation for the City. The Commission must act immediately to obviate any doubt that the City's property rights remain exactly that – the City's. Any further delay would be intolerable.

IV. Conclusion

For the reasons explained herein, the City urges the Commission to adopt the Proposed Decision – which correctly concludes that the Commission has no power to void the City's property rights.

April 14, 2004

Respectfully submitted,

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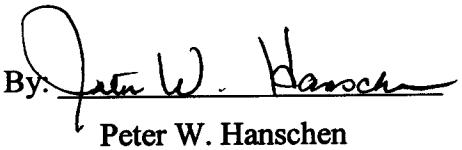
By: 

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CERTIFICATE OF SERVICE

I, Alma J. Gilligan, certify that on April 14, 2004, I served a true copy of the original attached document entitled **CITY OF FOLSOM'S ADDITIONAL COMMENTS ON THE PROPOSED DRAFT DECISION OF PRESIDENT PEEVEY AND COMMISSIONER KENNEDY** by email and first class U.S. mail to the attached service list.

Dated: April 14, 2004, at Walnut Creek, California.

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